No. 16177

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LYNDOL L. YOUNG and MILDRED W. YOUNG,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of the Decision of the Tax Court of the United States.

PETITIONERS' REPLY BRIEF.

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PETITIONERS' REPLY BRIEF.

The Brief of the Respondent is replete with incorrect statements of the record and the evidence in this case.

No facts are found or contained in the Memorandum Opinion of the Tax Court, as contended by the Respondent. Contrary thereto only conclusions are contained in the Memorandum Opinion of the Tax Court. Facts found must be based on the evidence. The Tax Court Opinion does not attempt to state the evidence which is uncontradicted, and does not support the Memorandum Opinion. The references in the opinion to the testimony of taxpayers as "vague" and "inconclusive," "meager" and "unsatisfactory" are mere conclusions. The evidence is to the contrary.

Residence Business Expenses.

Despite the repeated statement in Respondent's Brief that the taxpayer claimed as a business expense the sum of $9,493.62 in connection with the business use of his home where taxpayer carried on the substantial part of his law practice, the correct amount claimed by taxpayer was $5,843.62. There is no justification for the Respondent to misstate the correct amount of this item of business expense as there cannot possibly be any uncertainty about the same [see Tr. pp. 4-6, 13-14, 19, 88, par. 4; Supp. Tr. pp. 100-101]. Furthermore, as Respondent knows, the official files of the Respondent involving the income tax return of the taxpayer for the year 1952 contains taxpayers' protest to the Revenue Agent's report concerning his examination of taxpayers' records for the year 1952, and that said protest on page 5, paragraph 5, expressly states:

> "Taxpayers take exception to Finding (f) which completely disallows the claim of $9,493.62, which is reported as business promotional expense at 138 North June Street. The title of this expense is a misnomer as only a part of the $9,493.62 is applicable to 138 North June Street. Agent Morris was advised at the time of his examination of taxpayers records that the sum of $3,650.00 of said amount was attributable to cash received by taxpayer Lyndol L. Young from pocket checks drawn by him on his bank account and used by him in making cash disbursements for ordinary business expenses incurred during the year 1952, and that the sum of $5,843.62 was attributable to 138 North June Street."

The taxpayer's Brief filed with the Tax Court and served on Respondent's attorneys states unequivocally that

the amount of this item of business expense is $5,843.62 (Pet. Br. pp. 1, 3, 12, 18).

There is no justification, therefore, for the Respondent to attempt to misstate this item of business expenses, or any uncertainty concerning the amount thereof, as set forth in note 3, page 15, of Respondent's brief.

The Respondent is solely responsible for the inclusion in the income tax return of taxpayer for the year 1952 of the amount of this item of business expense, which is connected with the use of taxpayer's home as an office. The Respondent's files also contain a written formula which was established and prepared by the Respondent, and which sets up the allocation of the amount of the business expense connected with the taxpayer's home. This formula was prepared by the Respondent in connection with his examination of the taxpayer's income tax returns for the years 1948, 1949, 1950. The taxpayer followed this formula in his income tax return for the year 1952, and the amount claimed for the business use of the taxpayer's home is based on the Respondent's own formula. On the basis of his own formula the Respondent allowed the taxpayer as a business deduction for the use of his home in connection with his law practice the sum of $5,456.73 in the year 1948, and the sum of $4,747.76 in the year 1949, and the sum of $4,998.70 in the year 1950. The Respondent also allowed approximately the same home expense as a business deduction in the year 1951. Respondent is now attempting to renege on his own formula which the taxpayer followed in the year 1952. In view of this formula, how can the Respondent claim there was any mistake in allowing as a business deduction the amount hereinabove set forth during the years 1948, 1949, 1950 and 1951? Relying on this formula and with the

assurance of the Respondent that the same would be applicable not only in the years 1948, 1949, 1950 and 1951, but also as to all subsequent years, the taxpayer accepted the same and paid additional income taxes as follows: For the year 1948 the sum of $1,578.30; 1949 the sum of $1,592.22; 1950 the sum of $1,354.48; 1951 the sum of $1,499.95. The Respondent made a thorough and complete examination and investigation of the taxpayer's records and all of the facts concerning the business use of the taxpayer's home during the years 1948, 1949, 1950 and 1951, and concluded that the taxpayer was entitled to claim as a deduction a portion of the expense for the maintenance of said home, which included all of the items described in Respondent's Brief at page 14 as follows: "Butler, poultry, plumbing, cleaning and laundry, groceries, miscellaneous household, water, power and gas, garden, vegetables, yard maintenance, electric maintenance, florist and milk." The formula set up by the Respondent included, and was based upon, all of these items. As aforesaid, the taxpayer was assured by the Respondent that this formula would apply not only to the years then under investigation, to wit, 1948, 1949 and 1950, but also to all future years. This formula was followed by Petitioner in 1951, and the amount claimed for this same expense was approved by the Respondent. In 1952 Mr. Morris, the representative of the Respondent, refused in his report to follow this formula, and disallowed the claim of the taxpayer for this item of business expense *in toto*. It is undisputed that the total maintenance cost of taxpayer's home was $20,000 in 1952 [Tr. p. 34]. Following the Respondent's formula, the taxpayer allocated $5,-843.62 as a portion of the total cost of $20,000 as attributable to business expense, which amount is in line with the

amounts allowed by the Respondent under his own formula for the prior years above mentioned. In view of the Respondent's conduct in establishing his own formula to determine this item of business expense the statements in Respondent's Brief at pages 12 and 13 are hard to understand. Such statements completely ignore the fact that the Respondent is solely responsible for his own formula covering the amount claimed for this item of business expense, and there is no basis whatsoever for any criticism of the taxpayer in following the formula of the Respondent in claiming the sum of $5,843.62 to cover this item. Also, contrary to the Respondent's Brief that taxpayer made no showing of having used his home in 1952 in connection with his law practice, the record shows without contradiction that the taxpayer made the same use of his home in the year 1952 as he did in the years 1948, 1949, 1950 and 1951 [Tr. pp. 23-36]. In his testimony the taxpayer named the clients and the fees and the services rendered by him in his home during the year 1952. When the taxpayer attempted to go into the details of the services performed by him from his home he was admonished by Judge Mulroney that the Court was not interested in all of the details; that to go into such detail would be endless [Tr. p. 34]. The Respondent has completely failed to present the true record concerning the business use of taxpayer's home, and particularly the preparation of his own formula approving this use. He should not be permitted to repudiate his prior ruling based upon his own formula to the detriment of the taxpayer. There was no mistake and no attempt is made by the Respondent to show any mistake in the establishment of his own formula as a yardstick to determine the amount of this business deduction. How could there be any mistake of law or fact when the Respondent, after his own investigation and

examination of the taxpayer's records and the use made by the taxpayer of his home for business purposes, approved this identical claim for the prior years hereinabove mentioned? Certainly the Respondent would not be permitted to contend that a formula established by him and accepted by the taxpayer covering the depreciation of equipment or machinery could be changed by the Respondent in subsequent years arbitrarily and without justification. There is no distinction between this type of formula covering depreciation and the formula established by the Respondent covering the business use of the taxpayer's home. The Respondent seems to rest his attempt to repudiate his own formula established by him in 1953 and applied to the years 1948, 1949, 1950 and 1951 by insinuating to the Court at page 20 of his Brief that the cases there cited hold that "a failure by the Commissioner to challenge an incorrect claim may well indicate nothing more than oversight, error or lack of information rather than acquiescence as to taxpayer's claim." The taxpayer stated in his Brief at pages 14 and 15 that said claim for $5,843.62 as a portion of the sum of $20,000, the total cost for the maintenance of the taxpayer's home, followed a formula established by the Commissioner, and applied to the years 1948, 1949, 1950 and 1951. This statement has never been denied. This is not a case of mistake or error and no intimation has been made that there was any mistake or error until the Respondent filed his Brief. The formula referred to herein is in writing and is in the official files of the Respondent. The report of the Respondent's examining officer which applies this formula for the years 1948, 1949, 1950 is dated March 24, 1953. The report states: "The findings were discussed with the taxpayers. They have agreed with the findings, and have signed agreement form #870." The original of this report is

in the official files of the Respondent, and a copy thereof was received by the taxpayer from the Respondent. The taxpayer agreed to said findings of the Respondent's examining officer upon the consideration and assurance that the Respondent's formula covering the allocation of a portion of the cost of the maintenance of the taxpayer's home as a business expense would be followed by the Respondent, not only for the years 1948, 1949 and 1950, but also as to all future years while taxpayer used said home in connection with his law practice. Upon this consideration and assurance the taxapyer paid additional taxes for the years 1948, 1949 and 1950 in the total sum of $4,525, and prepared and filed his income tax return for 1952, insofar as this item of business expense was concerned, upon the basis of said formula.

It is also undenied that Mr. Wulke allowed the sum of $1,076 for the business use of taxpayer's home. In the deficiency letter of Respondent only the sum of $750 is allowed. It is a complete mystery to the taxpayer how either of these figures were arrived at, and it is obvious that both of said figures are arbitrary and the result of mere guessing. It is also undenied that Mr. Wulke allowed the sum of $2,000 for the business cash disbursement claim of the taxpayer in the sum of $3,150 [Tr. pp. 12, 15].

The plain fact is that the revenue laws and regulations involved in this matter are so indefinite, vague and uncertain that no legal standard is provided upon which the Respondent Commissioner determines the business deductions that he disallows or reduces. It seems to be a guessing contest from the start to finish.

Club Dues and Expenses Business Cash Disbursements.

The carping criticisms in the Respondent's Brief concerning the business use of the taxpayer's clubs is plain doubletalk. The snide remarks concerning the taxpayer on page 16 of said Brief are completely unjustified. It would be more appropriate to paraphrase the same as follows: It seems almost inconceivable that an individual with the presumed legal qualifications to represent the Respondent Commissioner would engage in such folderol as to intimate to the Court that the amount of the taxpayer's claim covering this item in the sum of $2,154 for club dues and expenses was not verified by the Respondent Commissioner prior to the trial, and that the amount of said expense was, therefore, an admitted fact. The Respondent well knows from his own files and reports that his agent Morris spent days in going over all of the taxpayer's checks and bills, including his club dues and expenses, and that there was no issue involved at the trial concerning the accuracy of all of the disbursements claimed by the taxpayer [Tr. pp. 42-43, 46, 51-52]. Neither has the Respondent put enough base under his argument that the club expenses claimed by taxpayer are not a business expense. The truth is that Respondent has admitted that it is a business expense, otherwise how does Respondent classify the allowance of 100% of all of the club dues paid by taxpayer as a business expense? The report of the examination of the Respondent concerning taxpayer's income tax return for 1952 contains the following statement:

> "Taxpayer claimed club expense which included dues and amounts paid on bills from the clubs. The amount allowed as a business expense is the club dues of

> $1,008.00. The remainder is disallowed as no business connection was shown by the taxpayer of these other amounts of $1,146.00 paid to the clubs" [Tr. pp. 69-70].

Apparently the Respondent's position is that it is all right for the taxpayer to belong to as many clubs as he desires and can afford, and that 100% of the dues paid to said clubs is a legitimate business expense but that, if taxpayer ever enters any of said clubs and incurs any expense in addition to his dues in connection with his business use of said clubs, the same is not deductible. The uncontradicted testimony of the taxpayer shows that the taxpayer used his clubs in connection with the legal business of his clients, and he named the clients that he consulted with in said clubs [Tr. pp. 27-29, 31-35, 43-44, 46, 50-51].

The Respondent's representative, Mr. Wulke, of the Appellate Division approved one-half of taxpayer's club expenses in addition to 100% of the club dues, to wit, $573 of $1,146 claimed. Furthermore, as hereinabove stated, Mr. Wulke allowed the sum of $2,000 for the business cash disbursements claimed by the taxpayer in the sum of $3,150. This item of business expense is completely ignored in the Memorandum Opinion of the Tax Court [Tr. pp. 12-13, 74, 78; Supp. Tr. pp. 101-103].

Following the conferences with Mr. Wulke held on October 20, November 15 and December 8, 1954, where the above mentioned business deductions were approved by Mr. Wulke in the amounts indicated, the Respondent confirmed said conferences as above set forth in his communication to the taxpayer dated March 9, 1955 [Tr. p. 10].

Travel Expense.

The only part of this claim that is inconclusive or vague or ambivalent, as characterized by Respondent's Brief, is the attempt of the Respondent to dodge his own records and acts. There is no justification for Respondent to criticize the taxpayer for not going into more detail concerning the legal matters attended to by taxpayer in connection with this disbursement. When the testimony of the taxpayer had reached this stage of the trial the noon hour had arrived. The trial started at 11:00 a.m. [Tr. p. 19]; the Court had set another case for 2:00 p.m. It was nearing 12:30 p.m. [Tr. p. 52]. The taxpayer had been told by the Court, in effect, to hurry along in the following language:

> "The Court: Do we have to go into all the issues, here? All this litigation could be endless, I'm sure. All I'm interested in is how his home was used and the club was used, for these things, without telling us so much of the issues of these cases" [Tr. p. 34].

The taxpayer, therefore, heeded the admonition of the Court and did not give any testimony regarding the specific cases and legal matters that occasioned the trips to Honolulu, Boston, Phoenix, La Jolla, San Diego and Palm Springs. Taxpayer spent a total of $7,500 for travel expense in 1952. This figure was verified by Respondent in his examination of taxpayer's checks and bills [Tr. pp. 51-52]. Taxpayer allocated $3,500 of the total amount of $7,500 as a reasonable portion to cover the business expense of said trips, as follows: Honolulu, $1,500; Boston, $1,000; all other trips $1,000.

It is difficult for the taxpayer to comprehend the base that Respondent puts under his allowed figure of $2,158.62

for this item of business expense. The Respondent's report, Tr. page 70, states:

> "Claimed on the return: $3,500.00. Allowed: $2,-158.62. Added to net income $1,341.38. The amount added to net income (1,341.38) represents one-half of the cost of $2,682.76 of a trip to Honolulu with taxpayer's wife. Taxpayer and wife spent three weeks in Honolulu, and failed to show that the trip was conducted for business purposes. The amount of $1,341.38 is considered to be a personal family expense for which deduction is denied under Section 24 (1) I. R. C."

It is, therefore, apparent that the Respondent from the very beginning allowed one-half of the amount of the Honolulu trip as a business expense. Taxpayer claimed $1,500. The Respondent allowed $1,341.38. Under these circumstances it is certainly error for the Tax Court to hold that the Respondent disallowed the deduction of the expense incident to the Honolulu trip. At the trial, the Respondent well knowing that he had already approved the business expense of said trip in the amount of $1,-341.38, conceded that the sum of $1,500 was a reasonable amount to allow for this trip. For the Respondent to take the position in his Brief that no such admission was made at the trial by Respondent's attorney is mere subterfuge. The Respondent had already approved the sum of $1,-341.38 before the trial [Tr. p. 70].

So far as the nature of the travel expenses are concerned, as questioned in Respondent's Brief, the taxpayer again reiterates that the Respondent had examined all of the bills and checks connected with this deduction, as well as all other business deductions claimed by the taxpayer, and had verified that taxpayer had spent the total sum of

$7,500 for travel expense in 1952, and had allocated $3,500 of said sum to business expense. How could the taxpayer know whether the Respondent allowed the expense claimed for the trip to Boston, to wit, $1,000? The total amount allowed by the Respondent for all travel expense was $2,158.62, which included the sum of $1,341.38 for the Honolulu trip, leaving a balance of $817.24 to cover all of the other trips made by taxpayer. Contrary to the statement in Respondent's Brief that the taxpayer only testified that he made a trip to Boston and New York, the record shows that taxpayer went to Boston to confer with the executives of the Liberty Mutual Insurance Company [Tr. p. 38]. Further, the record shows that in the year 1952 this particular client of the taxpayer paid the taxpayer the sum of $5,200 [Tr. p. 25], and had paid total fees to the taxpayer in the sum of $175,000 [Tr. p. 28]. The Respondent does not mention the Boston trip or any of the other trips and travel expense of taxpayer, except the Honolulu trip, in any of Respondent's reports, communications or notices to taxpayer, so how could the taxpayer know what was going through the Respondent's mind when he reduced this travel expense claim from $3,500 to $2,158.62. The same answer applies to the taxpayer's claim in the sum of $1,000 for trips to Phoenix, Arizona, to consult with his clients Mrs. Joseph Edward Thompson, Sr., and Mr. and Mrs. Joseph Edward Thompson, Jr., and the Filor sisters who paid the taxpayer a fee of $25,000 in the year 1952 for legal services on their behalf.

It should also be remembered that Respondent offered no evidence whatever at the trial to justify Respondent's reduction of any of the business claims made by taxpayer, including the claim for $3,500 for travel expenses. Tax-

payer was the only witness who testified at the trial. His testimony stands uncontradicted. The Tax Court may not arbitrarily discredit the testimony of an unimpeached taxpayer so far as he testified to facts.

In the case of *Blackmer v. C. I. R.*, 70 F. 2d 257, the Court states as follows:

> "A disregard of such testimony is sufficient for our holding that the taxpayer has sustained the burden of establishing his right to a reduction and error has been committed in a contrary ruling" [Pet. Tr. pp. 20, 21].

Conclusion.

The Respondent cites several cases but they do not contain the doctrine the Respondent urges on the issue of the failure of the Tax Court to make findings of fact. The two cases relied upon by Respondent disclose that the facts were found by the Tax Court in a statement of the facts which were set forth in the Memorandum Opinion, and which statement of facts were supported by the evidence as disclosed by the record. The Memorandum Opinion of the Tax Court in the taxpayer's case does not state any facts, but only conclusions. The decision of the Tax Court is, therefore, not supported by the evidence and the Tax Court has failed to make findings of fact in any form. Likewise, the cases cited by the Respondent concerning the issue of the right of Respondent to repudiate his former ruling, which was based upon his own formula in connection with the claim of the taxpayer covering the business use of his residence, do not support Respondent's contention. As hereinabove set forth, the Respondent advised the taxpayer on March 24, 1953, that the claim of the taxpayer for the years 1948, 1949 and 1950 had been allowed on the basis of a formula established by the Re-

spondent. On March 9, 1955, the Respondent advised the taxpayer that a deficiency had been determined for the year 1952 against the taxpayer in the sum of $7,705.78 [Tr. p. 9]. The statement attached to said notice of deficiency disclosed that the Respondent had repudiated his former ruling concerning the right of the taxpayer to claim a portion of the total expense for the maintenance of his home as a business expense. The amount claimed by the taxpayer in the year 1952 was $5,843.62, which was in line with the Respondent's formula. The Respondent reduced the amount claimed by the taxpayer to the arbitrary sum of $750. This new ruling of the Respondent was made retroactive to the year 1952. The cases cited by the Respondent do not justify his action which reverses his former ruling retroactively. Neither was there any mistake of law or fact involved in the Respondent's former ruling covering the years 1948, 1949 and 1950 and 1951. The cases relied upon by the Respondent involved either a mistake of law or a mistake of fact, which justified the Respondent in reversing his former ruling.

The case of *Lesavoy Foundation v. Commissioner of Internal Revenue*, 238 F. 2d 589, contains a correct statement of the law which is applicable to the factual situation in the taxpayer's case. See cases cited in footnotes at pages 591, 592, 593 and 594.

Respectfully submitted,

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